IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 81 of 1987

For Approval and Signature:

Hon'ble MR.JUSTICE M.S.SHAH
and
Hon'ble MR.JUSTICE D.A.MEHTA

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

COMMISSIONER OF INCOME TAX

Versus

JYOTI ELECTRIC MOTORS LTD

Appearance:

1. INCOME TAX REFERENCE No. 81 of 1987

MR BB NAIK with MR MANISH R BHATT for Petitioner No. 1

MR JP SHAH for Respondent No. 1

CORAM : MR.JUSTICE M.S.SHAH
and
MR.JUSTICE D.A.MEHTA

Date of decision: 01/11/2001

ORAL JUDGEMENT

(Per : MR.JUSTICE D.A.MEHTA)

The revenue has sought reference on the following three questions of law under section 256 (1) of the Income-tax Act, 1961 (hereinafter referred to as `the Act'):-

(i) "Whether, on the facts and in the circumstances of the case, the assessee is entitled to allowance of royalty payment of Rs.12,16,694/- as revenue expenditure?"

(ii) "Whether on the facts and in the circumstances of the case, the amount of Rs.3 lakhs being know-how fees and royalty of Rs.1,03,068/- payable to the Jyoti Ltd. are allowed as revenue expenses?"

(iii) "Whether in law and on facts, the assessee is entitled to the deduction of Rs.50,000/- as technical report fees?"

2. The assessment year is 1981-82 and the relevant accounting period if financial year ended on 31st March, 1981. The assessee is a limited company. The assessee claimed deduction on the following items in its return of income:-

(i) royalty payment of Rs.12,16,694/- paid to Jyoti Ltd. under agreement dated 1st September, 1972 as revenue expenditure.

(ii) Rs.3 lacs know-how fees and Rs.1,03,068/- being royalty paid to Jyoti Ltd. under another agreement dated 1st January, 1981 as revenue expenditure, and

(iii) Rs.50,000/- as technical report fees as revenue expenditure.

3. We have heard Mr BB Naik, learned Standing Counsel for the revenue-applicant and Mr JP Shah learned advocate appearing on behalf of the assessee-respondent.

4. In so far as question No.2 is concerned, it is common ground between the parties that the said question is concluded in assessee's favour by decision dated 3rd November, 1999 rendered by this Court in Income Tax Application No.269 of 1999 between the same parties.

5. In so far as third question is concerned, the Assessing Officer disallowed the sum of Rs.50,000/holding that the technical report fees were paid to Jyoti

Consultants Ltd. for ascertaining feasibility of manufacturing motors of different kind than the motors which were already being manufactured by the assessee-company. In appeal, the Commissioner (Appeals) held that in principle the payment was allowable as revenue expenditure because the report had been obtained for the purpose of expansion of existing business, "that expansion had actually taken place and the cost of capital assets had been duly capitalised in the year under consideration as well as subsequent years". However, for the purposes of ascertaining whether the payment had actually been made or not during the relevant accounting period, the CIT (Appeals) directed the Income-tax Officer to examine the various documents and then grant relief to the assessee.

6. The Tribunal has recorded in para-14 of its order that the Income-tax Officer examined the relevant papers and allowed relief to the assessee-company in pursuance of the directions issued by the Commissioner (Appeals). In light of the aforestated facts, the Tribunal concurred with the finding recorded by the CIT (Appeals) that expansion had actually taken place and that the cost of capital assets has been capitalised during the relevant accounting period as well as in subsequent years. The Tribunal thus upheld the claim of the assessee that the assessee-company was entitled to deduction of Rs.50,000/paid for technical report fees as revenue expenditure.

7. Having heard both the sides, we do not find any infirmity in the order of the Tribunal as both the CIT (Appeals) and the Tribunal have taken into consideration the facts on record and after appreciating the evidence, arrived at a finding of fact that the expenditure in question was incurred for the purpose of expansion of existing business. The third question is therefore required to be answered in favour of the assessee.

8. Coming to question No.1, it was the submission of Mr Naik that the issue has been concluded against the assessee by decision rendered between the same parties reported in (1999) 237 ITR 280. As against this, Mr JP Shah relied upon the decisions of this Court again between the same parties rendered on the following dates and in following references.

Sr. No.	Income Tax Reference No(s).	Date of decision	Assessment year

(1) 389/84	1-2-2000	1979-80
(2) 374, 374A & 374B of 1992	26-12-2000	1982-83, 1983-84 & 1984-85
(3) 192/94	26-12-2000	1985-86 & 1986-87

It was contended by Mr Naik that in all the aforesaid unreported decisions rendered by this Court reliance had been placed on the decision of CIT vs. Jyoti Ltd. (1971) 118 ITR 499 (Gujarat) while in case of reported decision in 237 ITR 280 this Court had subsequently referred to and upheld the finding of the Tribunal that the said decision was distinguishable on facts. According to Mr Naik, therefore, we should adopt the reasoning which appealed to this Court in the aforesaid reported decision and an additional factor for doing so, it was submitted was the fact that the decision of Apex Court in case of Jonas Woodhead and Sons (India) Ltd. vs. CIT 224 ITR 342 had been followed.

9. In view of the aforestated position, after hearing the matter partially it was adjourned so as to enable the parties to place the original agreement dated 1st September, 1972 on record. By consent of both the parties, the same has been taken on record.

10. Referring to the terms of the agreement, Mr Naik contended that the assessee had derived a benefit of enduring nature resulting in acquisition of the benefit in the capital field and hence the Income-tax Officer had rightly held that the expenditure in question was capital in nature and the deduction claimed was not permissible. It was contended that the agreement was initially for a period of ten years but the same was extendable for such further period as may be agreed in writing between the parties to the agreement. That even after expiry of the agreement period or the extended period, the agreement continued to remain in force until it was terminated by one of the parties by giving notice in writing of not less than one year. Mr Naik further submitted that this condition by itself went to show that this was an agreement which was not limited in point of time but was extendable for indefinite period and the assessee-company was entitled to utilise the technical data like drawing, specifications etc. for all times to come and hence the payment in question was not really royalty but capital expenditure for the purposes of acquisition of advantage in capital field. It was further submitted that even

after the termination of the agreement, the assessee-company was not required to stop manufacturing the said products nor was it stipulated that the technical knowledge acquired by the assessee-company was not to be utilized by the assessee -company in manufacturing the products which it was entitled to manufacture under the agreement.

11. As against this, our attention was invited by Mr Shah to the preamble of the agreement as well as various articles in support of his submission that the assessee was merely a licensee under the agreement and the rights to manufacture the specified products which were acquired under the agreement were only in relation to user of an asset and were not exclusively assigned to the assessee-company.

12. The preamble of the agreement dated 1st September, 1972 as well as Article 1 specifically make it clear that Jyoti Ltd. with whom the assessee-company has entered into an agreement has only granted the licence to manufacture electric motors which were being manufactured by Jyoti Ltd. and for this purpose Jyoti shall render technical and other experienced guidance to the licensee i.e. the assessee. It is pertinent to note that Jyoti has reserved the right to grant similar licence for manufacturing the same products covered under the agreement to any other party and furthermore the licensee, namely the assessee, is bound by the terms of agreement and the benefits under the agreement are nonassignable or nontransferable. The Articles dealing with the duration of the agreement as well as termination of agreement read together go to show that the agreement is liable to be terminated even earlier than the stipulated date and it is not necessary that the entire term for which the agreement is entered into, the assessee would be entitled to the benefits granted under the agreement. Article 3 which deals with right to sell motors has specifically provided that the sale of the defined products covered under the agreement shall be exclusively done through Jyoti Sales Organisation both within and outside the territories of India; and further that the agreement does not preclude Jyoti from manufacturing and selling the said products within the same territories i.e. within and outside India. There is a further stipulation in the same Article that in case Jyoti is unable to sell the said products manufactured by the licensee, the licensee shall be free to enter into direct sales but no other sole selling agent will be appointed by the licensee, and furthermore in such an eventuality it would be open to Jyoti, namely licensor,

to withdraw the use of its name on the said products manufactured by the assessee-company. Article 4 (E) specifically stipulates that all the technical documentation supplied by the licensor under the agreement shall be treated as strictly confidential and the licensee shall not be in a position to part with such information in favour of any other party. Similar provision is found in Article 5(D).

13. Over and above the aforestated terms and conditions stipulated in the agreement it is pertinent to note that the payment of royalty and fixation of price had been laid down in Article 8(A) of the agreement. The licensee is required to pay royalty at the rate of 7% on the net sale price of products manufactured in terms of the agreement to Jyoti and it is further provided as to what would be the net sale price in such circumstances. Therefore, the measure of payment of royalty is the sales made by the assessee-company.

14. Having considered the terms of the agreement in light of the law laid down by various decisions cited by both the sides, we feel that the assessee-company did not acquire any enduring advantage in the capital field in view of the terms and conditions stipulated in the agreement. The assessee-company has been merely granted a nonexclusive licence for the use of an asset and under the agreement, there is no acquisition of any asset which would render the payment in question to be treated as capital in nature. The royalty is payable on the basis of the sales which the licensee would make solely through the sole selling agent appointed by the licensor and thus the payment is strictly linked with the quantum of sales and would vary with the quantum of sales.

15. The decision rendered in Jyoti Electric Motors Ltd. vs. CIT, 237 ITR 280 was rendered in context of the following question which was there before the Court:-

> "Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the Commissioner was justified in passing the order under section 263 of the Act in setting aside the assessment order?"

16. The Tribunal had upheld that assumption of jurisdiction under sec. 263 of the Act by the Commissioner and the assessee in reference challenged that order of the Tribunal. The Court was called upon to opine as to whether prima-facie the Commissioner had correctly assumed the jurisdiction as held by the

Tribunal, and the Court was not called upon to render any opinion as regards the merits of the claim of the assessee. The observations made in the said judgment, therefore, shall have to be read as having limited application in the context of the controversy which was there before the Court.

17. As regards the contention of Mr Naik that the assessee company was entitled to continue to manufacture the motors under the agreement even after the expiry of the period of the agreement, it can be seen that such user was subject to the licensee company making payment of royalty on the basis of sales made on manufactured products after the termination of the agreement. What is more important, however, is that the licensee company is required to return to Jyoti Ltd. all the technical documentation within one month in the event of termination or lapse of the agreement. In this connection it is pertinent to note that, in the case of Commissioner of Income-tax vs. Power Build Ltd. (2000) 244 ITR 19, this Court has held that even in a case where the assessee was entitled to retain all the technical data, design, documentation etc. and there was also no restriction on manufacture, even then the payment of royalty was allowable as revenue expenditure in view of the fact that the assessee was not a new unit engaged in manufacturing and the benefit was acquired only for running the existing business. In the present case, admittedly the agreement was entered into on 1st September, 1972 and the assessment year in consideration is 1981-82. The Assessing Officer has disallowed the claim only on the basis of his orders for the earlier assessment years. Therefore, though a faint attempt was made by Mr Naik to contend that the assessee had not set up the business, the facts on record go to show otherwise and applying the ratio of the aforesaid decision in the case of Power Build Ltd. (supra) it is not possible to find any fault with the order of the Tribunal.

18. We have taken into consideration the following decisions cited by Mr Naik and Mr Shah respectively and have borne in mind the ratio of the said decisions while arriving at the aforesaid opinion.

Mr Naik:

(i) 237 ITR 280 (Guj) Jyoti Electric Motors Ltd. vs. CIT.

(ii) 224 ITR 342 (SC) Jonas Woodhead and Sons (India) Ltd. vs. CIT

Mr JP Shah:

(i) 87 ITR 400 (SC) Mewar Sugar Mills Ltd.
vs. CIT

(ii) 59 ITR 718 (SC) Gotan Lime Syndicate vs.
CIT.

(iii) 68 ITR 493 (SC) M A Jabbar vs. CIT

(iv) 236 ITR 314 (SC) CIT vs. Wavin (India)
Ltd.

(v) 232 ITR 316 (SC) CIT vs. I.A.E.C.
(Pumps) Ltd.

19. In light of what is stated hereinbefore, we hold that the Tribunal was right in law in holding that the assessee was entitled to allowance of royalty payment of Rs.12,16,694/- as revenue expenditure.

20. All the three questions are, therefore, answered in the affirmative i.e. in favour of the assessee and against the revenue.

21. The Reference stands disposed of accordingly with no order as to costs.

(M.S. Shah,J)

(D.A. Mehta,J)

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